NOTES

AN EXAMPLE OF MUNICIPAL RESEARCH[1]

Once in a while a public document appears which has significance out of proportion to its bulk. Such was the report of the Railroad Securities Commission on which President Hadley served, and such—though in a very different way—is the report of the Commission on Local Transportation appointed by Mayor Thompson of Chicago. A slight pamphlet in itself, it is an interesting landmark in the history of Chicago traction.

Present conditions and problems date back to the ordinance of 1907, which is now apparently doomed (if the courts sustain the City Council in declaring it void for non-fulfilment). At the time of its adoption a five-cent fare was highly profitable, but public interest appeared to center not so much in getting lower fares as in getting the old cable equipment replaced by trolleys, and in limiting private profit and paving the way for possible municipal purchase. The ordinance constituted a contract between the companies and the city, specifying a five-cent fare and setting up a valuation on which the companies should receive 5 per cent return, further profits to be divided, 55 per cent to the city and 45 per cent to the company. To accomplish the desired reconstruction of the lines, the companies were allowed to charge renewals to capital account during a period of three years, thus increasing their valuation and, in effect, including discarded property. Additions to plant were to be added to the valuation on the basis of cost, plus 10 per cent for taking charge of construction, plus 5 per cent for raising the funds. Under these provisions the valuation has grown from about $60,000,000 (including the original values set on two properties subsequently taken in) to about $160,000,000 at the present time. A board of supervising engineers consisting of one representative of the companies, one representative of the city, and an impartial chairman, audits the books and certifies expenditures for maintenance, renewals, and additions, thus continuing the valuation.

When war-prices made the five-cent fare inadequate, the city stood on its contract rights. A substitute plan, carefully worked out, for a

[1] *Report of Commission on Local Transportation of the City of Chicago*, 1920. Pp. 51.

trusteeship operating on the general principle of service at cost, was voted down at the polls, largely, it is thought, because of the personnel of the first board of trustees. The state Public Utilities Commission was appealed to and held that the city had no power to contract away the police power of the state over rates. The commission raised fares to seven cents, and finally, on November 5, 1920, to eight cents: a rate intended to produce approximately 10 per cent on the ordinance valuation, so that the companies' share should be not more than 7½ per cent after paying the city its share of the profits. The commission's own valuation is virtually a reproduction-cost valuation, with an addition for going value, "in the light of" the provisions of the ordinance allowing a value for discarded property and margins of 10 per cent and 5 per cent on new construction. The actual figures are found by the commission to be as follows: Ordinance valuation, as of June 1, 1919, $157,700,-461.59; cost of reproduction new, as of January 31, 1919, $170,000,000; cost of reproduction, less 20 per cent depreciation, plus $7,945,200 in the renewals fund, $143,900,000; original cost new of properties now (January, 1919) in service, $133,000,000; and original cost of property now (1919) in service less depreciation previous to 1907, $122,168,809.80; going value, not less than $20,000,000; fair value, not less than $163,900,000. On this basis the commission upheld the ordinance valuation (which was what the companies contended for) as being within the bounds of fair value. The reviewer might add a personal calculation that the original cost of the property in service January, 1919, less 20 per cent depreciation, plus $7,945,200 in the renewals fund, would come to $114,345,000.

Meanwhile Mayor Thompson had made the five-cent fare a campaign slogan, but some time was required to produce a plan for bringing this to pass. The city is debarred from purchasing the lines by the debt limit as at present laid down by the state constitution. If the denunciations of the state commission are to be taken at full value, they would seem to imply that a new commission, representing the Thompson faction, would give the city its five-cent fare. (A new commission has just been appointed by the newly inaugurated Governor Small, who represents the Thompson wing of the Republican party.) The Mayor, however, decided on a different course, and proposed the creation of a traction district covering the area of Chicago's local transportation system, and empowered to issue bonds, levy taxes, and acquire and operate the car lines at a five-cent fare. The district was to be governed by elected trustees, as is the present Chicago Sanitary District.

Objections to this plan were at once raised in no uncertain terms. It was a mere device for saddling a traction deficit upon the taxpayer with no effective check; it was an unnecessary multiplication of overlapping administrations and of elective officers, when the one thing vitally needed, if self-government is to regain more than a shadow of reality, is to lessen the number of elective offices and shorten the ballot; it would not work and was not meant to work, but merely to keep the issue alive as a political asset and keep the surface lines the football of politics indefinitely.

In the meantime the Mayor had secured authorization from the City Council for the appointment of a commission "to consider matters incident to obtaining improved local transportation . . . . at a permanent five-cent fare through the creation of a public body clothed with power to own, control, and operate a system of local transportation in . . . . the metropolitan district of Chicago." In other words this is a commission to study ways and means of promoting the Mayor's plan and detail matters concerned therewith, *not* a commission to study and determine what the best plan may be. This commission received an appropriation of $250,000 of which $180,000 has been spent and the Mayor recommends that the unexpended remainder be continued for the purpose of making further studies and "to present to the Legislature and the members and committees thereof such detailed information as may be required to promote the enactment of the enabling legislation." In other words, to lobby for the Mayor's plan at the state capitol.

However, the facts and arguments which the commission is to bring to bear on the legislature are not to be given to the general public, for in a masterly paragraph they explain that ". . . . at the suggestion of your Honor, we have omitted from our report this non-essential mass of detail, to the end that our conclusions and recommendations based on the studies and investigation of the legal and engineering staffs might not be obscured in the public mind through over-emphasis of some unimportant details by the opponents of people's ownership." Among the unimportant details which have been omitted, in order that they might not be over-emphasized by opponents of "people's ownership," one might mention a statement of the value of the properties, the amount of bonds that can be issued under the Mayor's plan in its relation to the value of the properties, of the actual operating revenues and expenses per passenger, and of the percentage earned on the value of the properties in recent years. The conclusion is that if these nonessential details were published, they would tend to obscure the desirability of the Mayor's plan in the public mind.

Aside from introductory matter, the report consists of about eight pages, of very moderate size, with a supplemental report of seven pages by the chief engineer and a draft of proposed enabling legislation occupying something more than twelve pages. True to the policy stated above, these pages contain not a single item of relevant factual evidence resulting from the engineering and other studies of the commission, being chiefly confined to blanket indorsements of the Mayor's plan. They do, however, contain a number of statements drawn from the campaign speeches of Mayor Thompson.

Among these is the charge that the company officials had testified (when trying to get taxes reduced) that the ordinance valuation included "$85,000,000 or $90,000,000 that is not represented by any property at all." The conclusion of the report is that the ordinance valuation is so unreasonably high that the city cannot purchase under it, and therefore that the Mayor's transportation district is a necessity. Aside from the fact that it needed no engineering investigation to reveal this bit of evidence, is it relevant? Only if the new district could secure the benefit of a lower valuation than the city, and on this point not a shred of evidence is furnished. Reason says that the new district could secure no more favorable valuation than a fair-minded public utilities commission would award in a rate case, especially if the ordinance of 1907 is declared void and so ceases to influence the commission's valuation, via "going value."

To prove that a five-cent fare is financially practicable, the report cites the total net income of the properties for twelve and one-half years, but it does not show what percentage this was on the investment, nor what the operating expenses or net earnings were in the recent years of price inflation, and it does include in income the reserve for renewals and other items of over $12,000,000[1] which are not earnings at all but mere bookkeeping entries added to capital account. The report also claims that, because the companies have kept secret books, no one knows the real cost of the service, and the implication is that improper items have been charged to operating expenses and kept secret. ("'Is that a fact?' said Mr. Hennessey. ''Tis a campaign fact,' replied Mr. Dooley.") The un-campaign fact appears to be that the books showing the *disposition of the company's net profits* are secret, but that the Board of Supervising Engineers audits the books showing operating expenses and all additions to capital. The secret books might show that expendi-

[1] This sum consists of the 10 per cent and 5 per cent above cost of new construction, which the companies are allowed to add to their valuation, as already stated.

tures for dubious and devious purposes have been made out of ***net profits***, but they could not possibly show that the operating expense accounts had been padded. The "improper items of expenditure" which might be "eliminated" if these secret books were opened, would be eliminated from the net profits, not from the operating expenses. Statements like these of the report are common enough in the cheaper grades of stump oratory; coming from a public commission after a year's study, such statements can hardly indicate anything but intent to mislead.

The facts as to expenses, as gathered from the abstract of record of the eight-cent-fare case (decided November 5, 1920) appear to be as follows: Operating expenses (not including anything that may be contained in secret books) for September, 1916, were 3.17 cents per revenue passenger; for August, 1919, 4.8 cents; for September, 1919, 5.15 cents, and estimated expenses for August 1, 1920, to July 31, 1921 (with new wage scale and two hundred added cars), about 5.75 cents. (The estimated expenses per 8-cent fare collected come to 6.1 cents, but the average revenue-per-revenue passenger runs perhaps 6 per cent less than the full fare). With taxes eliminated, the figure of 5.75 cents would be reduced to about 5.5 cents. If these figures are correct they mean that under present conditions, a five-cent fare would fail to cover operating expenses by about .84 cent, not counting anything for return on investment. These are perhaps some of the "unimportant details" which, if published, might be overemphasized by opponents of people's ownership, thus tending to obscure the commission's findings in the public mind. In any case, they are available to the public without the expense of an investigation by a staff of engineers.

The supplementary report from the engineering department of the commission is concerned not with past earnings but with future economies. The most startling is the claim that the organization of the proposed district "would double at once the capacity of the surface lines to transport people into and out of the so-called loop district."[1] How this could be done appears to be one of the nonessential details, save that it is to be accomplished by re-routing cars—a matter over which it had been supposed that adequate authority already existed. The total economies are "conservatively estimated" at $12,000,000 per year. This comes to about 26.6 per cent of the estimated expenses, excluding taxes, for 1920-21, though the report does not give it as a percentage sum.

[1] P. 27 of the report.

These economies are listed as follows: Elimination of the Board of Supervising Engineers and of cases before the Public Utilities Commission. (Are the costs of elections and administration of the proposed new district taken into account?) Discontinuance of spotters and gain in revenue through sale of tickets to passengers before entering cars. (Can *all* spotters and *all* cash fares be eliminated?) Saving on pay-roll of maintenance of way. Increasing average speed from ten miles an hour to twelve miles. The use of the loop system in the downtown district and at a number of terminals. Saving of revenue now lost through crowded conditions of cars. Saving of overhead costs including legal expense and lobbying. (Will there be no litigation incident to the proposed transfer, and no political expenses in the running of the district?) Generation of power instead of purchase. Saving in purchase of supplies in open competition. (Those who know the vagaries of "open competitive bidding" under certain types of political administration will discount this item, possibly more than 100 per cent.)

Claims like these cannot be verified, especially as the report itself furnishes no detail beyond what is indicated above. Their worth might be estimated by the reliability of other statements in the same report which are of a sort that can be verified. Judged on this basis, their value would be a minus quantity.

However, it might be of interest to work out a tentative budget, taking all these savings at their face value. For this purpose the estimated budget for 1920-21, already referred to, may be taken as a starting-point. Five-eighths of the earnings from passenger cars as given in this budget comes to a little less than $38,600,000. Operating expenses, not including taxes, come to $45,164,757, leaving a deficit of $6,600,000. Savings (including increased income and reduced expenses of $12,000,000) convert this deficit into a surplus of $5,400,000. Against this must be charged interest and sinking-fund requirements on the district bonds as required by the proposed law. With interest at 5 per cent and sinking fund requirements at 2 per cent, $5,400,000 would cover the charges on $77,000,000 of bonds. If the district, then, can buy or lease, on a basis of $77,000,000 at 5 per cent, properties which the state Public Utilities Commission a few months ago valued at over $160,000,000, and can secure the enormous savings predicted, they can be self-supporting on a five-cent fare, and the added burden on the taxpayer would be limited to making good the taxes formerly paid by these properties when under private ownership. If the people are competent to decide whether they want Mayor Thompson's plan or not, they certainly

should be competent to weigh such figures as these in deciding what the probabilities are that the plan would produce a five-cent fare without forcing the taxpayers to make good an annual deficit of millions of dollars.

The report concludes with a draft of proposed enabling legislation. The outstanding feature of this is the fact that the only kind of public ownership it provides for is ownership bound by law to fix fares at five cents and to levy taxes to pay interest and sinking-fund charges on the bonds issued, and (in the discretion of the trustees) operating deficits also. It would seem that the people should have the option whether they would establish public ownership on a plan which is required to pay expenses and allowed to give a five-cent fare if possible, or on a plan which is required to give a five-cent fare and allowed to pay expenses if possible, or on a plan where this matter is left optional so far as the enabling legislation is concerned.

It is also quite possible to pass legislation which would give the existing city government power to issue bonds beyond its present debt limit, for the acquisition of productive business properties. This would be far less like an evasion of the intent of the debt limitation, especially if the property acquired by such bond issues is required by the enabling law to be self-sustaining. In assuming that the creation of a new district is the only legal method of acquiring the roads, the report overlooks an obvious alternative which would appeal to the soberer citizens as distinctly preferable. The fact that the city's consent is required to empower the district to construct and operate any lines within its limits (section 7 of the proposed law) is only one example of the artificial unwieldiness arising out of the creation of another independent, co-ordinate public body to perform a city function.

Another major feature is the fact that the bonding power of the proposed district (5 per cent of the assessed valuation) would come to about $80,000,000, or half the value of the properties as fixed by the 1907 ordinance or by the Public Utilities Commission. The report does not mention this fact, nor say a word as to ways and means whereby this discrepancy can be overcome. The plan simply does not furnish a means whereby the lines can be acquired, let alone operated, unless a judicial miracle occurs. How such a fact can be calmly ignored in an official document is one of the mysteries of American government.

A minor matter is the curious wording of section 9 of the proposed law which appears unintentionally to authorize the levying of taxes in any one year sufficient to cover *twice* the amount of the annual bond charges, as well as any excess of operating expenses over total receipts.

The language of this section should certainly be changed if the measure is enacted, for as it stands the provision has all the appearance and effect of a "joker."

As an economic document the report is not worth the space that is here given to it, nor the paper it is printed on. As an example of everything that municipal research should not be, it has more significance. As a phase of the general crisis in public utilities it may be more important still. It is truly a symptom of the force of popular discontent with attempts to regulate private utilities corporations, and especially with the results of valuations based on reproduction-cost plus going value. Fortunately or unfortunately, the companies are in a position in which they need not fear this discontent too seriously, so long as their position can be attacked only through a forced purchase in which the courts could probably be counted on to protect the same high valuation on which rates are fixed. More prominent in the public mind, perhaps, is inadequacy of service. It appears that the two ends—adequacy of service and economy in rendering it—are hard to secure together. The easiest way to secure economy seems to be to give a private company a share of what they can save at fixed rates of fare (preferably revised at considerable intervals). But the company can always save by skimping the amount of service rendered as well as by economical handling of what it does render, and attempts at enforcement of adequate service have had discouragingly small results in Chicago. On the other hand, with the spur of profit removed, the resistance to increased service is removed, but with it goes the incentive to other and more desirable forms of economy, and it becomes necessary to try to secure economy by direct supervision. It seems likely that years of discomfort in crowded cars may tend to make people readier to grasp the second horn of this dilemma. With the recent defeat at the polls of the plan for service at cost under trustees, the stage is set for the Mayor's plan.

The situation is serious, and a standpat policy will be as futile as it would be unwise. It is to be hoped that Mayor Thompson's plan is not so bad as the feebleness of this report would indicate, because anything the Mayor really wants he is extremely likely to get. One possibility is that Mayor Thompson does not particularly care to have his plan put in force, but would prefer to make his opponents shoulder the blame for defeating it. Possibly if the courts refuse to declare the present ordinance void, the Mayor may interpret this as making his plan impossible. In any case, the plan is sure to be blocked by the fact that the

bonding power of the proposed district is far less than any valuation a court could possibly fix. Such an obvious defect makes it hard to believe that the plan is seriously intended to work as advertised. One might say that the plan is cleverly devised so that the lines could be bought only if the courts would allow the Mayor's most extreme claims as to the amount of water in the valuation and would cut the present valuation in two, and this, of course, the courts will not do. Will the Mayor, then, be satisfied merely to keep the matter unsettled while he makes political capital out of the campaign issue thus manufactured? The fact that the companies are not opposing the Mayor's plan lends color to this supposition. A more serious danger is that if his opponents try to outguess him by failing to oppose his plan, or to offer an adequate substitute, both sides may be outguessed and the plan may go through.

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SOME RECENT FINANCIAL DEVICES

The participating bond is one of the rarest devices in American corporation finance.[1] The Disco Milling Company, an Illinois corporation, is now financing the development of a new flour-milling device through an issue of participating bonds which present certain novel features. The capital required for the purchase of a building and the installation of equipment is to be secured through the sale of $500,000 of twenty-year 6 per cent first-mortgage bonds which carry the privilege of participation in the profits of the corporation on the following basis: 10 per cent of the net earnings of the company is to be set aside for retirement of the principal of the bonds. Whenever the fund so accumulated amounts to $25,000, it is to be applied to the retirement of the principal of the bonds, the face of each bond being reduced pro rata. To facilitate this operation, $50 principal coupons are issued to make up each $1,000 bond. Of the remaining profits, 25 per cent goes to the bondholders and 75 per cent to the stockholders. As no stock is offered to the public, this 75 per cent represents the equity of the inventor, the promoters, and others concerned with the earlier development of the invention, and with its financing. Retirement of part or all of the principal of the bonds

[1] Three cases of its use are cited by Dewing (*Financial Policy of Corporations*, I, 87), all of them obsolete bonds, and no others seem to have been noted by the authors of current financial literature. The writer's attention has been called also to a participating bond issued by McNally-Peck & Company, an Indiana onion producer, four or five years ago, which is still extant.